

***United States Court of Appeals  
for the Second Circuit***



**APPENDIX**



ORIGINAL

76-4062

B/PC

IN THE  
**United States Court of Appeals**  
FOR THE SECOND CIRCUIT

POIRIER & McLANE CORPORATION,

*Appellee,*

*v.*

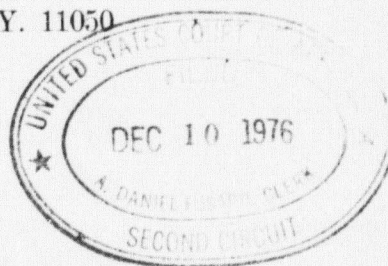
COMMISSIONER OF INTERNAL REVENUE,

*Appellant.*

ON APPEAL FROM THE DECISION OF THE  
UNITED STATES TAX COURT

**APPENDIX TO APPELLEE'S PETITION FOR  
REHEARING IN BANC**

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SENATE REPORT  
U.S. CODE CONGRESSIONAL  
AND ADMINISTRATIVE NEWS  
VOLUME 1  
88th CONGRESS, SECOND SESSION  
AT PAGE 1773.

"Timing of deductions and credits in certain cases where asserted liabilities are contested (sec. 224 of the bill and sec. 461 of the code)

"(a) Present law. -- Prior to the decision in the Consolidated Edison case the Internal Revenue Service generally held that the payment of a contested tax liability resulted in the tax being considered as deductible even though the tax was still being vigorously denied and contested. In the Consolidated Edison case decided in 1961 the Supreme Court held that a contested tax even when paid does not accrue as a deduction for income tax purposes until the contest is terminated. It was held that the tax was not deductible until after the contest was settled because all of the events which would determine whether or not the amount would ultimately have to be paid would not be determined until that time.

"(b) General reasons for provision. -- Although your committee does not question the legal doctrine laid

down by the Supreme Court in the Consolidated Edison case, it believes that it is unfortunate to deny taxpayers a deduction with respect to an item where the payment has actually been made, even though the liability is still being contested either as to amount or as to the item itself. The objective of the reporting of items of income and deduction under the internal revenue laws generally is to realistically and practically match receipts and disbursements attributable to specific taxable years. The internal revenue laws contain a number of adjustments designed to accomplish this result. Your committee believes that allowing the deduction of items in the year paid, even though they are still being contested in the courts or otherwise, more realistically matches these deductions up with the income to which they relate than would the postponement of the deduction, perhaps for several years, until the contest is settled. To the extent that deductions are allowed under this rule and then subsequently as a result of the contest the items were found not to be payable, adjustment can be made for this overstatement of the deduction by the inclusion of the overstatement in income in the year in which the amount of the liability is finally determined.

"(c) General explanation of provision. -- In view of the above consideration, your committee has amended the provision of the existing law which specifies the year for the taking of deductions or credits generally. The amendment provides that if a taxpayer contests an asserted liability, such as a tax assessment, but makes a payment in satisfaction of this liability and the contest with respect to the liability exists after the payment, then the item involved is to be allowed as a deduction or credit in the year of the payment. This is based upon the assumption that the deduction or credit in this case would have been allowed in the year of payment, or perhaps in an earlier year when it would have been accrued, had there been no contest.

"The treatment provided here can be illustrated by an example. Assume that in 1965 a \$100 liability is asserted against a business which it pays at that time but contests the liability in a court action. Assume further that in 1967 the court action is settled for \$80. Under present law, before the enactment of this provision, the deduction of \$80 would be allowed in 1967. Under your committee's action, the taxpayer could claim a \$100 deduction in 1965 but then in 1967 would have to take \$20

into income except as provided in section 111 of the code, relating to recovery of bad debts, prior taxes, and delinquency amounts.

"In those cases where payment is not made until after the contest is settled, this does not prevent an accrual basis taxpayer from accruing the deduction or credit in an earlier year in which the contest is settled.

"A similar amendment to that described above is also made to the Internal Revenue Code of 1939."

SENATE SUPPLEMENTAL REPORT  
U.S. CODE. CONGRESSIONAL  
AND ADMINISTRATIVE NEWS  
VOLUME 1  
88th CONGRESS, SECOND SESSION  
AT PAGE 1912.

"Section 224. Timing of deductions and credits in certain cases where asserted liabilities are contested.

"Section 224 of the bill, which was added by your committee to the bill as passed by the House, amends section 461 of the 1954 Code (relating to general rule for taxable year of deduction) and section 43 of the 1939 Code (relating to period for which deductions and credits taken), and provides certain transitional rules. No provision of this section of the bill extends the period of limitations within which a claim for credit or refund may be filed for any taxable year.

"(a) Taxable year of deduction or credit. -- Paragraph (1) of section 224(a) of the bill, which was added by your committee to the bill as passed by the House, amends section 461 of the 1954 Code, relating to general rule for taxable year of deduction, by adding to such section a new subsection (f). In G.C.M. 25298, 1947-2 C.B. 39, the Internal Revenue Service took the

position that a taxpayer may deduct the amount of taxes paid to local authorities not later than for the year of payment even though he contests liability for such taxes. In 1961, the U.S. Supreme Court held that, where an accrual basis taxpayer contested taxes paid to local authorities, the contested amount was deductible for the taxable year in which the contest was settled rather than for the taxable year in which such amount was paid (U.S. v. Consolidated Edison Co. (1961) 366 U.S. 380). The new subsection (f), in the case of contested taxes, provides that the contested amount is deductible for the year of payment.

"The new subsection (f) provides in effect that if (1) a taxpayer contests an asserted liability (such as a tax assessment); (2) such taxpayer transfers money or other property to provide for the satisfaction of the asserted liability; (3) the contest with respect to the asserted liability exists after the time of the transfer; and (4) but for the fact that the asserted liability is contested, a deduction or credit would be allowed for the taxable year of the transfer (or, in the case of an accrual method taxpayer, for an earlier taxable year for which such amount would be accruable), then the deduction or credit shall be allowed for the

taxable year of the transfer.

"The new subsection (f) is not limited to an asserted liability for taxes, but applies to any asserted liability where the requirements of the new subsection (f) are met. A taxpayer may provide for the satisfaction of an asserted liability by transferring money or other property to the person who is asserting the liability, or by a transfer to an escrow agent provided that the money or other property is beyond the control of the taxpayer. However, purchasing a bond to guarantee payment of the asserted liability, an entry on the taxpayer's books of account, or a transfer to an account which is within the control of the taxpayer is not a transfer to provide for the satisfaction of an asserted liability.

"The new subsection (f) applies only if the contest with respect to the asserted liability exists after the time of payment. Thus, the new subsection (f) does not apply to Z corporation in the following example:

"Example. -- Z corporation uses the accrual method of accounting. In 1968 a \$100 liability is

asserted against Z. Z contests the asserted liability. In 1967 the contested liability is settled as being \$80 which Z accrues and deducts for such year. In 1968 Z pays the \$80.

"If any portion of the contested amount, which is deducted in the year of payment, is refunded when the contest is settled, such portion is includible in gross income except as provided in section 111 of the 1954 Code, relating to recovery of bad debts, prior taxes, and delinquency amounts.

"The new subsection (f) may be illustrated by the following examples:

"Example (1). -- X corporation, which uses the cash method of accounting, in 1964 contests \$20 of a \$100 asserted real property tax liability but pays the entire \$100 to the taxing authority. In 1968, the contest is settled and X receives a refund of \$5. Under the new subsection (f) of section 461 of the 1954 Code, for the taxable year 1964 X deducts \$100 and for the taxable year 1968 X includes \$5 in gross income (assuming sec. 111 of the 1954 Code does not apply to such amount).

"Example (2). -- Y corporation, which uses the accrual method of accounting, in 1964 contests \$20 of a \$100 asserted real property tax liability but pays the entire \$100 to the taxing authority. In 1968, the contest is settled and Y receives a refund of \$5. Under the new subsection (f) of section 461 of the 1954 Code, for the taxable year 1964 Y deducts \$100 and for the taxable year 1968 Y includes \$5 in gross income (assuming sec. 111 of the 1954 Code does not apply to such amount).

"Paragraph (2) of section 224(a) of the bill, as added by your committee, amends section 43 of the 1939 Code, relating to period for which deductions and credits taken, by adding at the end of such section a new sentence. The new sentence is the same as the new subsection (f) added to section 461 of the 1954 Code by paragraph (1) of section 224(a) of the bill."

CONFERENCE REPORT  
U.S. CODE, CONGRESSIONAL  
AND ADMINISTRATIVE NEWS  
VOLUME 1  
88th CONGRESS, SECOND SESSION  
AT PAGE 1977.

"Amendment No. 97: This amendment adds a new section to the bill, relating to the time of deductions and credits in certain cases where asserted liabilities are contested.

(a) Taxable year of deduction or credit. --  
Subsection (a) of the new section amends section 461 of the 1954 code (relating to general rule for taxable year of deduction) and section 43 of the 1939 code (relating to period for which deductions and credits taken) to provide that if --

- (1) the taxpayer contests an asserted liability;
- (2) the taxpayer transfers money or other property to provide for the satisfaction of the asserted liability;
- (3) the contest with respect to the asserted liability exists after the time of the transfer; and

(4) but for the fact that the asserted liability is contested, a deduction or credit would be allowed for the taxable year of the transfer (or for an earlier taxable year); then the deduction or credit shall be allowed for the taxable year of the transfer."

VOLUME 110, CONGRESSIONAL RECORD  
SENATE DEBATE AT PAGE 1454.

"24. Deduction of contested liabilities. The bill would allow a deduction for the taxable year in which a taxpayer pays a tax or other liability, even though he contests the liability."

VOLUME 110, CONGRESSIONAL RECORD  
SENATE DEBATE AT PAGE 3517.

"Sixth. The House accepted the Senate amendment which provides that the year a taxpayer contests a tax or other liability he is, nevertheless, to be permitted a deduction for the item in the year for which he makes a payment, if this is earlier than the year in which the contest is settled. It is the understanding of the conferees that the new provisions relating to the timing of deductions, in certain cases where asserted liabilities are contested, do not affect the taxable year in which the taxpayer may deduct items of a nature which are properly accruable in a year before the year of payment."

6

VOLUME 110, CONGRESSIONAL RECORD  
HOUSE DEBATE AT PAGE 3562.

"Fourteenth. The House conferees accepted a Senate amendment which provides that where a taxpayer contests a tax or other liability he is nevertheless to be permitted a deduction for the item in the year in which he makes a payment, if this is earlier than the year in which the contest is settled."

VOLUME 110, CONGRESSIONAL RECORD  
HOUSE DEBATE AT PAGE 3565.

"Section 223, contested items: Where a taxpayer contests a tax or other liability, he is, nevertheless, to be permitted a deduction for the item in the year in which he makes the payment if this is earlier than the year in which the contest is settled."